

MEMORANDUM



DATE: August 4, 2005
TO: House Appropriations Subcommittee on Transportation
FROM: William E. Hamilton
RE: State Support for Local Public Transit

The current year (FY 2004-05) state transportation budget (HB 5528, enacted as PA 361 of 2004) includes \$292.3 million in appropriations for public transportation programs.¹ These appropriations, representing approximately 9% of the \$3.3 billion state transportation budget, are funded from state-restricted, federal, and local revenue sources as shown below.

FY 2004-05 State Appropriations for Public Transportation Programs by Revenue Source (in millions)

Comprehensive Transportation Fund (CTF)	\$232.3
Federal Transit Administration (FTA)	59.2
Local Revenue (local matching funds)8
Total	\$292.3

Appropriations from the CTF support a number of public transportation programs, including targeted transit programs (e.g., transportation-to-work, specialized services), intercity bus, rail passenger, and rail freight programs, as well as administration of the Michigan Department of Transportation's Bureau of Multi-modal Transportation Services. However, the largest share of CTF revenue is appropriated for capital and operating assistance to the state's 79 local public transit agencies. The distribution of public transportation funds in the state budget is largely directed by the provisions of Public Act 51 of 1951 (Act 51).

There are three main appropriation line items in the state transportation budget which help support local transit systems. Those line items, as authorized in the current year budget and as proposed in the FY 2005-06 Executive recommendation, are shown in the table below.

Line Item	Appropriation FY 2004-05	Executive Rec. FY 2005-06	Fund Source/Description
Local bus operating	\$161,680,000	\$163,276,100	All state-restricted (CTF). Distributed to all 79 local transit agencies by Act 51 formula as a percentage of eligible operating expense – up to 50% for urban, up to 60% for non-urban.
Nonurban operating/capital	\$14,600,000	\$14,600,000	Federal Transit Administration (FTA) grants, plus \$200,000 local matching funds, to transit agencies in non-urbanized areas. Distributed in part based on operating expense; part used for capital grants.
Bus capital	\$38,500,000	\$49,311,400	\$30.0 million FTA funds, plus CTF and \$500,000 local matching. CTF is \$8.0 million in FY 2004-05, \$18.8 million in FY 2005-06 Executive-proposed budget. Supplemented by CTF bond proceeds and toll credits.

¹ The \$292.3 million figure used in this memo does not include appropriations for aeronautics programs, which are included in the Act 51 definition of public transportation, and also excludes certain relatively small state and federal revenue sources used in the budget for specific rail and bus programs.

Note on Appropriated Revenue

The state-restricted revenue as shown in the state transportation budget, including CTF revenue, is based on Michigan Department of Treasury estimates. The federal revenue in the budget is based on the Michigan Department of Transportation's best estimate of available federal grants at the time the department submits its budget request to the State Budget Office. The department also estimates the amount of local revenue needed to match federal grants.

In addition to the federal funds appropriated in the state budget, transit agencies in urbanized areas are able to access federal grants directly. These FTA grants do not flow through the Michigan Department of Transportation and are not shown in the state transportation budget. Also, most local transit agencies receive local support through millages or from general fund contributions of local units of government, in addition to revenue generated from farebox collections.

CTF Revenue Issues and Local Public Transit Programs

Actual CTF revenue for FY 2003-04 was \$235.7 million, \$10.7 million less than the prior fiscal year. Current year CTF revenue is projected to be \$224.9 million, a decline of an additional \$10.7 million – \$21.4 million less than the FY 2002-03 baseline.² This reduction in CTF revenue has reduced state funding available for local transit programs. CTF revenue sources and budgetary issues related to the CTF are described more fully in our companion memo, "Comprehensive Transportation Fund Revenue Issues," dated August 4, 2005.

The balance of this memo discusses the impact of reductions in CTF revenue on the two largest CTF-funded appropriation line items in the state transportation budget, *Local bus operating*, and *Bus capital*.

CTF Revenue Issues and Bus Capital

Despite the reduction in CTF revenue in FY 2003-04 and FY 2004-05, state appropriators did not reduce appropriations for local bus operating assistance, the largest CTF-funded line item. Instead, funding for several other CTF line items was reduced or eliminated. One of the largest reductions was in the *Bus capital* line item.

The CTF revenue in the *Bus capital* line item provides the non-federal match for FTA grants to local transit agencies. CTF revenue is used to match both federal funds appropriated in the state transportation budget (for non-urban transit systems), and federal grants made directly by the FTA to transit agencies in urbanized areas. FTA grants typically require a 20% non-federal match.

Section 10e (4) of Act 51 effectively requires that not less than \$8.0 million from the CTF be distributed each year for matching federal capital grants. Section 10b (3)(f) of Act 51 further requires that the state pay not less than 66 2/3% of the local match required for FTA capital grants to local transit agencies. Historically the state has provided 100% of the non-federal match from CTF appropriations. However, because of reductions in CTF revenue in the *Bus capital* line, the department is currently using other sources to provide the local match, including bond proceeds and toll credits.

CTF bond proceeds – State Transportation Commission revised project lists for recent CTF bond issues (Series 2002B and Series 2003) have included a total of \$61.1 million to be used to provide the non-federal match for federal bus capital and facility grants.

Toll credits -- Toll credits are a method of providing a "soft-match" for federal funds. According to the American Association of State Highway and Transportation Officials' "Innovative Finance" website, <http://www.innovativefinance.org>, the use of toll credits was first authorized under Section 1044 of the Intermodal Surface Transportation Efficiency Act (ISTEA) and, later, under Section 1111(c) of the Transportation Equity Act for the 21st Century (TEA-21). Toll credits "*permitted states to substitute certain*

² Current year CTF revenue estimates of \$224.9 million are actually \$7.3 million less than current year CTF appropriations of \$232.3 million.

previous toll-financed investments for State matching funds on current Federal-aid projects. This means that the non-federal share of a project's cost may be met through a "soft match" of toll credits. This increases the flexibility of state transportation finance programs by allowing states to use toll revenues when other state highway funds are not available to meet nonfederal share matching requirements."

The web publication further states: *"Toll credits are earned when the state, a toll authority, or a private entity funds a capital transportation investment with toll revenues earned on existing toll facilities (excluding revenues needed for debt service, returns to investors, or the operation and maintenance of toll facilities). The amount of credit earned equals the amount of excess toll revenues spent on nonfederal highway capital improvement projects."*

Although the use of toll credits allows a local transit agency to access a federal grant without the use of its own local funds, it provides a smaller total grant than the use of actual CTF revenue. For example, the Ann Arbor Transportation Authority (AATA) recently received a federal capital grant of \$2,608,000. The state provided a "soft match" using toll credits equal to 20% of the grant (\$521,600), which allowed the AATA to access the \$2,608,000 grant. However, the \$2,608,000 represented the total grant revenue available to the AATA. If the state had been able to provide a \$521,600 "hard match" using actual CTF revenue, the AATA would have been able to access a total of \$3,129,600 to fund capital projects.

As noted above, the state has historically provided 100% of the non-federal match for federal capital grants to local transit agencies. However, reductions in CTF revenue may jeopardize the state's ability to provide either 100% of the non-federal match, or even 66 2/3% of the non-federal match as required by Act 51. One factor in this equation is the amount of federal aid available. The state is anticipating an increase in federal aid to Michigan in the reauthorization of TEA-21. To the extent that more federal aid is available, the amount of non-federal match required will also increase.

The state's ability to provide matching funds for federal grants also depends on the amount of CTF revenue appropriated in the *Bus capital* line item. The amount appropriated in turn is dependant on how much state-restricted CTF revenue is available for appropriation. If there is not sufficient CTF revenue to provide 100% of the non-federal match for federal capital grants, the state may continue to use toll credits to provide a "soft match." The state may also be forced to reduce its share of the non-federal match to something less than 100%. Reducing the state's participation would effectively require local transit agencies to provide their own local funds for part of the match. Some transit agencies would be able to fund some of the match from local sources. However, some transit agencies may elect to forgo available federal grants if local funds are not available or are allocated for other purposes.

CTF Revenue and Local Bus Operating Assistance

As noted above, the appropriation for local bus operating assistance was not reduced in FY 2003-04 or FY 2004-05 despite reductions in available CTF revenue. Nonetheless, as transit agency budgets increase (in total), state assistance as a percentage of transit agency eligible operating expense continued to decline.

The formula for distributing local bus operating assistance is based on provisions of Act 51 as amended by PA 79 of 1997. Those provisions provide for the reimbursement of *up to* 50% of eligible operating expense for urban transit systems, and *up to* 60% of eligible operating expense for non-urban transit systems.

Although Act 51 establishes the 50% and 60% reimbursements as ceilings, representatives of transit agencies generally consider them to be goals and view reimbursement at less than those percentages as underfunding. Except for FY 1997-98, state operating assistance for transit systems has not reached the 50% and 60% ceilings established by Act 51.

The current year state appropriation of \$161.7 million is not large enough to fund transit systems at the 50% and 60% levels. The estimated reimbursement, based on transit agency budget estimates, will be 32.4% of eligible operating expense for urban systems and 38.9% of eligible operating expense for non-urban systems. See Appendix A for a description of how this distribution is computed.

The portion of transit agency expense not reimbursed from the state operating assistance has to be covered by farebox revenue, local contributions, or federal funds (for non-urban systems).

Note that the department makes the original distribution based on transit agency budget estimates. The final distribution is based on actual/audited eligible expense. The entire *Local bus operating* line item is distributed to transit agencies; the department does not hold back or lapse any of the funds in this line item.

Appendix A – Computation of Local Bus Operating Distribution

When the Michigan Department of Transportation distributes state operating assistance, it computes the assistance at either 50% or 60% of the submitted budgets of the various transit agencies and then reduces the computed distribution amounts proportionally to hit the amount of the actual appropriation. For example, the current fiscal year appropriation of \$161.7 million is 64.9% of the \$249.2 million needed for reimbursement at the 50% and 60% ceilings. As a result, the department computes the distribution to urban agencies at 64.9% of the 50% ceiling, and the distribution to non-urban at 64.9% of the 60% ceiling. See table below.

FY 2004-05 Distribution of Local Bus Operating Assistance Based on Budget Estimates			
To Compute Maximum Reimbursement (per Act 51)	Eligible Operating Expense	Act 51 % Ceilings	Maximum Reimbursement
Urban Systems	\$386,098,800	50.00%	\$193,049,400
Non-Urban Systems	93,604,650	60.00%	56,162,790
	\$479,703,450		\$249,212,190
Appropriation as a Percent of Maximum Reimbursement			
Appropriation	\$161,680,000		
Maximum Reimbursement	249,212,190		
Percentage of Maximum	64.88%		
To Compute Actual Reimbursement Percentages			
	Act 51 % Ceilings	Percentage of Maximum	Actual Reimbursement %
Urban Systems	50.00%	64.88%	32.44%
Non-Urban Systems	60.00%	64.88%	38.93%